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C O N F I D E N T I A L SECTION 01 OF 03 NEW DELHI 002021

EEB FOR SMANN
EEB FOR DAS DHENGEL, SGALLOGLY, SCOULTER, KBEL
DEPARTMENT OF ENERGY FOR A/AS KFREDRIKSEN, RCOOPER,
TCUTLER, SBISCONTI

E.O. 12958: DECL: 07/24/2028
TAGS: EPET ENRG EFIN EINV EWWT EAGR PGOV PREL IN IR
PK, TX, ZK, SL
SUBJECT: IPI GAS PIPELINE ON BACK BURNER; RETAIL REFINED
OIL PRODUCT PRICE HIKE NEEDED BY OCTOBER

REF: A. NEW DELHI 1310
¶B. NEW DELHI 1498
¶C. NEW DELHI 1512
¶D. NEW DELHI 1519
¶E. NEW DELHI 1607

Classified By: ECON MINCOUNS JOHN W DAVISON, FOR REASONS 1.4 B,D

¶1. (C) SUMMARY: India's Ministry of Petroleum and Natural Gas (MPNG) Secretary M.S. Srinivasan met with Econ Counselor Minister on July 22. Srinivasan said that IPI negotiations are "completely on the back burner." Concerning the proposed Turkmenistan- Afghanistan-Pakistan-India (TAPI) natural gas pipeline, Srinivasan underscored the GOI's concern that the audit of the Dauletabad natural gas field be completed in September and that the project be based on international competitive bidding (ref A). He cited progress in India's building up of its strategic petroleum reserve (SPR) with a view towards eventually qualifying for International Energy Agency (IEA) membership. He called the GOI's June 4 hike in controlled retail prices for refined petroleum products "inadequate," predicted that another price hike would be required by October. END SUMMARY.

No Movement on IPI Negotiations

¶2. (C) Secretary Srinivasan, who will retire on July 31, is India's main negotiator for the proposed Iran-Pakistan-India (IPI) natural gas pipeline, has been influential in the U.S.-India Energy Dialogue's Oil and Gas Working Group, and is a regular Embassy interlocutor. As chief negotiator for the IPI pipeline, Srinivasan dismissed recent Indian and Pakistani press speculation of a renewed tripartite meeting allegedly to be held in July or August and said that the long-stalled talks are "completely on the back burner." He cited French oil company Total's July announcement that it would pull out of its oil and gas exploration activity in Iran as evidence of international oil companies' "complete disenchantment" with Iran for any hydrocarbon deals. He repeated his assessment of last May (ref A) that the primary outstanding, "deal-breaking" issues for IPI remain:

-- Iran's insistence that India take ownership/possession of India's portion of the natural gas at the Iran/Pakistan border, whereas India demands Iran not relinquish its responsibility for the gas until it crosses the Pakistan/India border;
-- Iran has been unwilling to dedicate a particular natural gas field for production to supply the IPI pipeline; and
-- Iran has not provided a reliable and independently-confirmed audit on condition/volume of gas in the potential fields for dedication to the IPI project.

¶3. (C) Srinivasan also indicated that, contrary to press reports, India and Pakistan have not settled some of the key bilateral issues for the IPI pipeline: the amount of the transit rights fees and transportation expenses payable by India for its portion of the gas piped across Pakistan. He remains convinced that the IPI project would not be commercially viable for Pakistan to go it alone without the volumes to be sold to India.

¶4. (C) Srinivasan claimed he recently bluntly told Pakistan's Foreign Minister -- who wears a second hat by functioning also as Pakistan's energy minister -- that "you (Pakistan) simply do not have the money needed to build your section of the IPI pipeline." He remarked on his frustration in dealing with Pakistan's energy ministry due to its frequent changes in its top officials. "The last four times I have met with Pakistan's energy ministry, I have met with a different counterpart each time," he complained. According to MPNG's internal assessments, Pakistan's oil and gas situation is "desperate," with its domestic gas production rapidly declining and no progress on construction of a liquefied natural gas (LNG) terminal, which is its sole option for importing gas outside of the problematic IPI and TAPI proposals, he said.

TAPI Needs Sustained USG Action

¶5. (C) Concerning the TAPI pipeline, Srinivasan underscored his request last May (ref A) for continued USG action in favor of realizing two key aspects of the recent agreement: (i) completion by September of the independent audit of the production potential of Turkmenistan's Dauletabad natural gas fields; and (ii) adherence to International Competitive Bidding for the TAPI project. He voiced skepticism of any pronounced figures, absent an audit, for recoverable gas reserves, saying he usually discounts reported figures by a factor of five.

India's Strategic Petroleum Reserve (SPR) and IEA
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¶6. (SBU) India's SPR is progressing with its first phase of 100,000 barrels, and the GOI/MPNG is now in the process of identifying partners for construction of the second phase of its SPR for another 100,000 barrels. India wants to show the International Energy Agency (IEA) that it is serious about its SPR (ref B) and the GOI prefers to the have the "comfort in its own backyard" afforded by having such a reserve, he said.

Refined Oil Products Retail Price Controls; Oil Bonds
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¶7. (C) The GOI's most recent hike on June 4 (ref C,D,E), for diesel, petrol (gasoline), and liquefied petroleum gas (LPG) was "completely inadequate," said Srinivasan, to deal with the GOI-owned, MPNG-controlled refined oil product retail companies' financial crisis due to "under-recoveries" -- the difference between controlled retail prices and the market price needed to cover costs. Srinivasan has publicly advocated over the last year that prices must be decontrolled and that the current policy of subsidies, price controls and oil bond issuances is "un-sustainable."

¶8. (C) Srinivasan said that he told India's Finance Minister Chidambaram that the June 4th refined product retail pricing policy package -- including modest price hikes, reductions in central and state taxes, new oil bond issuances, and burden sharing by GOI-owned domestic oil producers -- would stem the under-recoveries crisis for the GOI-owned retail companies only until October, when another round of price increases would be required. The problem will remain as long as retail prices do not cover the cost of buying crude oil at international prices on world markets, since India now relies on imports for 75% of the crude oil that it consumes, he said.

¶9. (C) Srinivasan is "disappointed" that state governments in financially better-off states, such as Andhra Pradesh, had decided in June to reduce most of their state tax levy on diesel and petrol in order to partially offset the GOI price rise, thereby passing the savings onto the customer as a lower overall increase in retail prices. As a result, he said, it will be politically harder for the GOI to increase prices by much in October, as many states will have already used up the amount by which they can reduce taxes to mitigate the GOI-owned retail companies' share of the increase. .

¶10. (C) Already the oil bonds issued by the GOI are trading at a discount, Srinivasan noted. Moreover, GOI fertilizer bonds -- which partially make up for the under-recoveries from natural-gas-based, domestically-produced, subsidized retail fertilizer prices, which do not cover the cost of productions -- are trading at an even greater discount, he said. However, the Fertilizer Ministry has more flexibility, since it buys its natural gas inputs from the MPNG's companies and so it can ask the MPNG for a delay in payment or discount on the natural gas it uses for fertilizer production. By contrast, the GOI-owned petroleum product refiners and retailers must come up with U.S. dollars in cash to pay at the time of purchase to Saudi Arabia and other international oil traders at world prices, he said. Whereas Pakistan can ask Middle Eastern oil producers for an "Islamic credit or discount" on crude oil purchase, India must pay world prices, he added.

¶11. (SBU) For India's Fiscal Year (IFY) 2007-2008 (April 1, 2007 to March 31, 2008), the GOI will have to issue a total of 350 billion Indian rupees (INR) in oil bonds or about US$8.1 billion to cover part of the IFY 2007-08 under-recoveries. Of this total bond amount, INR 240 billion (US$5.7 billion) in oil bonds have already been issued and INR 110 billion (US$2.4 billion) in oil bonds is awaiting final approval by India's parliament.

¶12. (C) For IFY 2008-2009 (April 1, 2008 to March 31, 2007), Srinivasan estimates that total under-recoveries for GOI-owned refined product retail companies will reach INR 1,900 billion (US$44 billion) based on an average Indian Basket crude oil market price of US$127 per barrel. The MPNG wants 50% of the projected IFY 2008-09 under-recoveries to be covered by issuance of new oil bonds in the amount of INR 950 billion (US$22 billion), he said. However, the Ministry of Finance has told the MPNG that it prefers to approve oil bonds to cover only 42% of the projected under-recoveries by issuance of INR 800 billion in oil bonds (about US$18.6 billion), with a disparity of INR 150 billion (US$3.4 billion) between the MPNG and Finance Ministry positions, he said.

Krishna-Godavari Basin Natural Gas

¶13. (SBU) Finally, Srinivasan confidently predicted that the new offshore natural gas production from southeast India's Krishna-Godavari Basin's offshore fields will start production in September at a rate of 40 million standard cubic meters a day (mmscmd) or 14.6 billion cubic meters a year (bcm/y) and will increase to 80 mmscmd or 29.2 bcm/y by mid-2009. (NOTE: India produced 32.2 bcm in FY 2005-06 and imported an estimated 9.7 bcm on LNG. END NOTE).
WHITE